No. 9902

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GOLDEN STATE THEATRE & REALTY CORPORATION (a California corporation),
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONER.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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STATEMENT OF BASIS OF ORIGINAL AND APPELLATE JURISDICTION.

The jurisdiction of the United States Board of Tax Appeals is based upon the provisions of C. 234, Section 900 (e) of the Revenue Act of 1924, 43 Stat. 336, as amended, giving said Board jurisdiction of cases in which the Commissioner of Internal Revenue has determined deficiencies in income and other tax matters. The jurisdictional facts are alleged in the petition filed with the United States Board of Tax Appeals. (Tr. pp. 3-6.)

The jurisdiction of this Honorable Court is based upon Sections 1001-1003 of the Revenue Act of 1926,

C. 27, 44 Stat. 9, 109-110, as amended, providing for the review of the Board decisions by the Circuit Court.

Petitioner's returns during all the years in question were filed by petitioner with the Collector of Internal Revenue for the First District of California, the office of said district being located within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit. (Tr. p. 13.)

STATEMENT OF THE CASE AND QUESTION INVOLVED.

This appeal involves income taxes for the calendar year 1936 and said appeal is taken from a judgment of the Board of Tax Appeals holding adversely to petitioner with respect to a petition to redetermine income tax deficiencies found by the Commissioner of Internal Revenue. The case is brought before this Court by petition for review filed July 16, 1941. (Tr. p. 12.) The question presented is whether or not the Board of Tax Appeals erred in determining that there was received from San Francisco Wigwam Theatre Co., a wholly owned subsidiary of Golden State Theatre & Realty Corporation, likewise a California corporation, petitioner herein, 4397 shares of the capital stock of petitioner as a taxable dividend under the provisions of Section 115 (a) and (j) of the Revenue Act of 1936[1] and in holding that the said shares of petitioner's capital stock were of a value to petitioner as of the date of the alleged receipt.

1. See Appendix i.

SPECIFICATION OF ERRORS.

The petitioner relies on the following specification of errors:

(1) The Board of Tax Appeals erred in the determination that there was received from San Francisco Wigwam Theatre Co., a California corporation and a wholly owned subsidiary of Golden State Theatre & Realty Corporation, likewise a California corporation, petitioner herein, 4397 shares of the capital stock of petitioner and that said alleged receipt is taxable to petitioner as a dividend under the provisions of Section 115 (a) and (j) of the Revenue Act of 1936.

(2) The Board erred in the determination that said 4397 shares of petitioner's capital stock were of a value to petitioner, at the date of said alleged receipt, of $65,295.45.

(3) The Board erred in the determination that said 4397 shares of petitioner's capital stock were not treasury stock of petitioner while in the hands of San Francisco Wigwam Theatre Co., a wholly owned and fully controlled subsidiary.

(4) The Board erred in concluding that provisions of California law under which shares of the stock of a parent corporation held by a wholly owned and controlled subsidiary must be regarded as treasury stock, are irrelevant to the application of the Federal Revenue Act.

(5) The Board erred in determining income tax deficiency for the year 1936 in the sum of $15,562.51.

(6) The Board erred in not ordering and deciding in favor of petitioner and against respondent.

SUMMARY OF THE EVIDENCE.

The case was submitted on a written stipulation of facts, which facts were found by the Board of Tax Appeals as stipulated and are included as a part of the record on appeal. (Tr. pp. 19-34, incl.) No other or additional evidence was introduced.

Briefly summarized the facts of the case are as follows:

Petitioner has been engaged in the theatre business in the City and County of San Francisco, State of California, for a number of years, approximately fifteen, last past and immediately preceding the year 1936. San Francisco Wigwam Theatre Co. is also a California corporation, having its principal place of business in San Francisco. Both of these corporations were in existence during all of the times referred to in this brief. In the year 1931 and continuously up to and including the present time, petitioner owned all of the issued and outstanding capital stock of San Francisco Wigwam Theatre Co. and as a result San Francisco Wigwam Theatre Co. was a wholly owned subsidiary of petitioner.

During the year 1931 San Francisco Wigwam Theatre Co. acquired by purchase from outside parties 4397 shares of the capital stock of petitioner. Certifi-

cates evidencing those shares were issued to and in the name of San Francisco Wigwam Theatre Co. by Petitioner and so stood of record continuously until December 15, 1936. The persons from whom said shares were purchased and the manner and mode of payment are set forth in the stipulation which is part of the record. (Tr. pp. 21-24, incl.)

On May 12, 1936, the Board of Directors of San Francisco Wigwam Theatre Co. authorized the transfer of said 4397 shares by the subsidiary to the parent, petitioner herein, by a resolution donating the stock purchased by it to petitioner. (Tr. pp. 31-34, incl.) On December 15, 1936, the transfer was made and new certificates evidencing said shares were issued in the name of petitioner.

It was stipulated that the book value of the shares involved was the sum of $65,295.45 (Tr. p. 24) and respondent held that this amount was taxable to petitioner as a dividend under Section 115 (a) and 115 (j) of the Revenue Act of 1936. Petitioner contended that this was not a taxable dividend because the shares involved were treasury stock of petitioner in the hands of San Francisco Wigwam Theatre Co. and in receiving its own stock petitioner received nothing of value to itself.

SUMMARY OF ARGUMENT.

Petitioner was not taxable on the dividend alleged to have resulted from the transfer of this stock from the subsidiary to the parent by reason of the fact that under the laws of the State of California said stock was treasury stock and the same was of no value to petitioner. Therefore, the transfer resulted in no gain to petitioner even though it might be held to be a dividend. In other words, no property of value was transferred, no gain resulted and to levy a tax where no tax is due would be to violate the purpose and intent of the Internal Revenue Act.

ARGUMENT.

I.

THE TRANSFER INVOLVED WAS NOT A TRANSFER OF VALUE.

It is the contention of petitioner that the transfer of the stock involved herein from San Francisco Wigwam Theatre Co. to Golden State Theatre & Realty Corporation, petitioner, was not a transfer of value and therefore was not taxable. At the time of the receipt of the shares by petitioner entries were made upon its books and records treating the stock as treasury stock. The first entry in relation to this stock on April 3, 1937 (Tr. p. 23) treated the stock as an asset even though as a matter of law, as will hereinafter be shown, said stock was not at any time an asset of petitioner. Thereafter and on January 2, 1938, as a

result of an independent examination made by Robert O. Folkoff, C.P.A., the entry of April 3, 1937 was reversed to reflect the true situation in relation to the stock. (Tr. p. 24.) Such independent auditor, realizing that an error had been made in the original entry considering the stock as an asset of petitioner, corrected such entries to show that the surplus was not affected by the acquisition of such stock and that the same was not an asset. A new entry was added as a mere memorandum entry to record the acquisition of the shares and to show that they did not affect the net worth of the corporation. (Tr. p. 24.) The entire transaction set forth above, both from an accounting standpoint and an actual standpoint, was simply a bookkeeping transaction, there being no transfer of property of value.

If we assume for the purpose of argument that petitioner purchased this stock from its surplus from the same persons from whom it was purchased by San Francisco Wigwam Theatre Co., there would be no question of a tax arising in this case. It appears to petitioner that there is no difference in this instance between the acquisition by San Francisco Wigwam Theatre Co. and the supposed acquisition by petitioner in the first instance. This contention is clearly supported by the laws of the State of California and by the other authorities hereinafter cited. Sections 342, 342a and 342b[2] of the Civil Code of the State of California establish a system or scheme relating to the

2. See Appendix i-v.

acquisition by a corporation of its own stock. These sections must be read together in order to determine their legal effect and the rules as established therein must apply with equal force to the acquisition of its own stock by a parent or by a parent through a subsidiary. To do otherwise would be to disregard the force of the statute and to provide a means of accomplishing indirectly what cannot be accomplished directly. Therefore, in the case before the Court the acquisition of the stock of petitioner by San Francisco Wigwam Theatre Co. was in legal effect the same as if the stock was acquired by petitioner. This because in the hands of San Francisco Wigwam Theatre Co. under the sections hereinabove referred to the stock was subject to the same prohibitions as if it was originally purchased by petitioner. Section 342 of the Civil Code, supra, provides in part as follows:

> "A corporation may not purchase directly or indirectly any shares issued by it or by any corporation by which it is controlled, except as follows: * * *"

Section 342a of the Civil Code, supra, sets forth the effect of the acquisition of such shares and Section 342b of the Civil Code, supra, specifically prohibits treasury stock from being used for certain purposes, stating in part as follows:

> "* * * Treasury shares shall not carry voting or dividend rights and shall not be counted as outstanding shares for any purpose, nor as assets for the purpose of computing a surplus available for

> dividends or the purchase of shares issued by the corporation or the making of any other distributions to its shareholders. * * *"

It is therefore petitioner's conclusion that the stock had no value whatsoever either to San Francisco Wigwam Theatre Co. or petitioner unless it was at a later date resold. In determining the nature of treasury stock the case of *Borg v. International Silver Co.* (1925), 11 F. (2d) 147, held as follows:

> "Treasury shares are necessarily retired in this sense: That they constitute no longer any liability of the defendant. A corporation can have no right of action against itself, as must be if the share is truly a liability. Indeed, the only difference between a share held in the treasury and one retired is that the first may be resold for what it will fetch in the market, while the second has disappeared altogether. * * *
>
> To carry the shares as a liability and as an asset at cost, is certainly a fiction however admirable. They are not a liability and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset because as they stand, the defendant cannot collect on them. What in fact they are is an opportunity to acquire new assets for the corporation's treasury by creating new obligations. * * * In any event, there can be no ambiguity in stating the facts more directly * * *; that is, in treating the shares as not in existence while held in the treasury except as a possible source of asset at some future time, when by sale at once they become liabilities and their proceeds assets."

Contrary to the foregoing position the respondent takes the stand that the receipt by petitioner of the shares of its own stock constituted the receipt of a taxable dividend. It must be admitted even by respondent that petitioner received nothing other than treasury shares. These shares were of no value to it. Therefore, being of no value, they did not constitute a taxable dividend. Section 115 (j) of the Revenue Act of 1936 provides as follows:

> "If the whole or any part of a dividend is paid by a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value *at the time as of which it becomes income to the shareholder.*" (Italics supplied.)

Assuming for the purpose of argument, only, that the transfer of this stock from San Francisco Wigwam Theatre Co. to petitioner was a dividend, it is still contended that the transfer was not taxable within the meaning of Section 115 (j), supra. In order for a dividend in property other than money to be taxable, such a dividend must be income to the recipient. Income is defined as a *gain* derived from capital, from labor or both combined. (Regulations 94, Art. 22(a)-1.) Thus to determine if the dividend resulted in income to the shareholder we must see if there was a gain. That question is determined by the nature of the property interest which the shareholder has acquired. That in turn is determined by state law, for, as was held in the recent case of *Morgan v. Commissioner* (1940),

309 U. S. 75, 60 S. Ct. 424, "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, *so created,* shall be taxed." (Italics supplied.)

Petitioner is a corporation organized and existing under and by virtue of the laws of the State of California and its entire operations are controlled by state law. Its property rights may be restricted and affected by that law and as a matter of fact its rights are affected and restricted by the operation of the Civil Code sections of the State of California hereinabove referred to. Petitioner contends that where its property rights are so affected by California law the fixing of values cannot be determined independently of California statutes. As a result of these statutes the stock is subject to the same prohibitions and limitations upon its uses and values in California or anywhere else.

The member of the Board of Tax Appeals in considering this point erred in entirely disregarding the effect of state law. In the opinion of the Board it was said "irrespective of whether the petitioner's shares when owned by the Wigwam corporation could be regarded for purposes of California law as treasury stock, this would be irrelevant to the application of the federal statute". (Tr. p. 10.) It is obvious, then, that the Board member disregarded the application of California law in considering the value of this stock either in the hands of San Francisco Wigwam Theatre Co. or in the hands of petitioner on the assumption that the state law is irrelevant to the application of the federal

statute. The case of *Morgan v. Commissioner,* supra, would seem to require the state law to be applied in a situation of this type and, in addition, it is contended that there is an analogy between the application of the Federal Revenue Act to the community property cases and to the instant case. In other words, the United States Supreme Court has held that the Internal Revenue Act must be applied in relation to the property laws of the several states, thus recognizing that the nature of that property is affected by state statute. In *Poe v. Seaborn* (1930), 282 U. S. 101, 51 S. Ct. 58, the question was whether it was proper for a husband and wife to file separate income tax returns for the year 1927. It was undisputed that all of the property of the parties consisted of community property but the Commissioner contended that all of the income from this property should have been reported in the husband's return. However, the Commissioner conceded that the answer to the question involved had to be found in the provisions of the law of the state in determining the wife's ownership of or interest in the community property. The Court so held and this case established the principle in relation to the reporting of income from community property, thereby determining that the nature of the interest of the parties in and to community property must be determined by the law of the state in question. This case was followed without question in *Goodell v. Koch* (1930), 282 U. S. 118, 51 S. Ct. 62; *Hopkins v. Bacon* (1930), 282 U. S. 122, 51 S. Ct. 62; *Bender v. Pfaff* (1930), 282 U. S. 127, 51 S. Ct. 64; *United States v. Malcolm* (1931), 282 U. S. 792, 51 S. Ct. 184; see, also, *Lang v.*

Commissioner (1938), 304 U. S. 264, 58 S. Ct. 880; *Cannon v. Nicholas* (1935), 80 F. (2d) 934.

It would appear, then, that there is no difference between a state statute affecting property of individuals and a state statute affecting the property of a corporation. If the Internal Revenue Act must be considered in the light of the interest of husband and wife in property as determined by state statute, why should not the same rule apply in determining property rights in relation to a corporation? The sections of the Civil Code of the State of California, supra, definitely affect the use and value of the stock involved in this case and that value cannot be determined for the purpose of taxation under the Federal Revenue Act without considering the effect of the California law. To do otherwise would be to ignore the true nature of the transaction as determined by California law and to place a tax where no tax is due.

Supporting the principles advanced herein is the case of *Tooley, Executor v. Commissioner* (1941), 121 F. (2d) 350, in which this Court stated that the question to be determined was whether a surviving co-tenant's estate vested by transfer from his co-tenant at the latter's death or vested when the joint tenancy was created. This question, the Court said, was to be determined by California law, that state being the state in which the property was located. It concluded that under California law there was no transfer at the death of one joint tenant to the other, stating:

> "In California the surviving co-tenant no more has anything transferred to him on the other co-tenant's death than does the grantee of a remain-

> der in fee have anything transferred to him by the life tenant at the latter's death. Quite likely, the change by enhancement to the fee owner by the death of the life tenant could be made the 'occasion' for an excise tax, but it would be a distortion of all California and common law concepts of property ownership to call the 'change' a transfer from the life tenant."

It was the contention of the Commissioner in this case that California law should not be determinative on the ground that "taxation is 'eminently practical' and is not to be restricted by refined technicalities of local law". To this the Court answered:

> "We see nothing in section 311 which requires us to hold the character of the survivor of a joint tenancy in California held by its courts to be that of the common law to be a 'refined technicality of local law'. To sustain the Commissioner concerning such an estate in California would be a repudiation of Erie Railway Co. v. Tompkins, 304 U. S. 64, rather than an 'eminently practical' extension of the federal power of taxation."

The importance of state law in determining questions of the nature of this case before the Court is indicated by the decision of the Supreme Court in the case of *Blair v. Commissioner* (1937), 300 U. S. 5, 57 S. Ct. 330. The taxpayer in that case was the beneficiary of a testamentary trust. He executed certain assignments of the income of that trust to his children, in advance, and the income was actually paid to them. The Commissioner contended that the income was taxable to the petitioner and not to the assignees. The

Court, however, held that the tax was to be imposed on the one who was to receive the income as the owner of the beneficial interest and it must look to the law of the state to determine who is the owner of the beneficial interest. The Court said in part:

> "If under the law governing the trust, the beneficial interest is assignable, and if it has been assigned without reservation, the assignee thus becomes the beneficiary and is entitled to rights and remedies accordingly.
>
> * * * * * * *
>
> "The question of the validity of the assignments is a question of local law. The donor was a resident of Illinois and his disposition of the property in that State was subject to its law. By that law, the character of the trust, the nature and extent of the interest of the beneficiary, and the power of the beneficiary to assign that interest in whole or in part are to be determined."

It is submitted that the problem of the case before the Court affords a close analogy to that presented in *Blair v. Commissioner,* supra. There the tax was to be imposed on the one who received the income and that fact had to be determined by a consideration of state law; here the tax is to be imposed if income was received and whether or not income was received must be determined by a consideration of state law. Here the petitioner is a resident of the State of California and its use and disposition of the property of that state is subject to its law. By that law the character of the property, the nature and extent of the interest of petitioner and the power of petitioner to use that property in any way are to be determined.

II.

THE SUBSTANCE AND NOT FORM SHOULD BE DETERMINATIVE OF THE APPLICATION OF THE TAXING ACT.

The preceding argument has been devoted to the proposition that the stock was valueless to petitioner from the time of its acquisition by San Francisco Wigwam Theatre Co. and has never been of value to petitioner insofar as this case is concerned, there being nothing in the record to indicate that it has been sold. If this Court should hold that this stock is of value, it would be looking to form alone and disregarding the substance and real nature of the entire transaction. It has been the contention of respondent in this case that the transfer of the stock of record from the books of San Francisco Wigwam Theatre Co. to the books of petitioner resulted in a dividend in kind as of the book value of said stock to the subsidiary. It is the position of the petitioner, borne out by the authorities and arguments hereinabove set forth, that the purchase of the stock by the subsidiary was in effect the purchase by the parent. It is clear, then, that because of the peculiar method which was followed in this case the respondent is attempting to collect a tax which is not at all merited by the actual facts. It is submitted that petitioner should not be penalized because it indulged in a form which might be construed to be taxable when in fact no taxable transaction resulted. The federal cases hold that substance and not form determines the application of the taxing act to gains and losses where property is transferred to one corporation controlled by another. This rule was applied in the case of *Labrot v. Burnet* (1932), 57 F. (2d) 413,

and in *Commissioner v. Woods Machinery Co.* (1932), 57 F. (2d) 635, in the latter case in which it is stated:

> "Whether acquisition of its own capital stock gives rise to a taxable gain or loss depends upon the real nature of the transaction."

The transaction here involved merely a bookkeeping transfer of treasury stock from a wholly owned subsidiary to its parent. This transfer did not and could not result in income to the transferee. It would be an anomaly indeed if the law would hold contrary to the fact. It was held in the case of *Robert P. Hyams Co., Inc. v. United States* (1928), 26 F. (2d) 805:

> "The trend of authority is to the effect that mere bookkeeping methods neither create nor change any fact; that bookkeeping entries have only an evidentiary value; that the courts, in the absence of positive law to the contrary, will construe a revenue law as intended to reach actual income, the books to be regarded as neither indispensable nor conclusive; and that a decision must rest upon the actual facts."

In addition, Treasury Regulations 94, Revenue Act of 1936, Art. 115-3, state:

> "In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive."

If, then, the laws of the State of California must be applied in determining this case, the application of that law to the case hereinabove cited supports the

contention of petitioner that the respondent is attempting to take advantage of simple bookkeeping transactions to collect a tax, even though those entries and the transfers referred to do not and did not actually result in an increase in the assets of petitioner or a gain within the meaning of the Internal Revenue Act.

It is therefore submitted that the Board erred in its decision in holding that the laws of the State of California did not apply and in ignoring the fact that income did not result from this transaction by reason of the fact that the stock was of no value to petitioner, as hereinabove set forth. It is further submitted that it is not the purpose or intent of the income tax law to permit, nor should this Court permit, a tax to be collected in any case where no tax is due.

Dated, San Francisco,
October 22, 1941.

Respectfully submitted,
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(Appendix Follows.)

Appendix.

Appendix

Revenue Act of 1936:

Sec. 115. Distributions by Corporations.

(a) Definition of dividend.—The term "dividend" when used in this title (except in Section 203 (a) (3) and Section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(j) Valuation of dividend.—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Civil Code of the State of California:

Sec. 342. Acquisition by a corporation of its own shares and shares of a holding corporation: (When permissible: Available funds: Reduction of surplus). A corporation may not purchase directly or indirectly any shares issued by it or by any corporation by which it is controlled, except as follows:

(1) To collect or compromise in good faith a debt, claim or controversy with any shareholder;

(2) From shareholders who by reason of dissent from any proposed corporate action are entitled under section 369 of this title to be paid the fair market value of their shares;

(3) From one who as an employee other than as an officer or director has purchased such shares from the corporation under an agreement reserving to the corporation the option to repurchase or obligating it to repurchase such shares;

(4) To eliminate fractional shares;

(5) To redeem or purchase shares subject to redemption at prices not exceeding the redemption price thereof;

(6) To carry out provisions of its articles authorizing conversion of its shares;

(7) Pursuant to section 348b of this title; or

(8) Subject to any limitations contained in its articles, out of earned surplus.

Shares may be acquired either out of stated capital or from any surplus under subdivisions (1) to (5) inclusive of this section. Purchasers from earned surplus under subdivision (8) of this section are not limited to cases authorized under other subdivisions of this section.

(Reduction of surplus.) Upon any purchase of such shares out of earned or paid-in surplus when authorized under this section, the earned or paid-in surplus

shall be reduced by an amount equal to the purchase price of such shares, but the stated capital shall not be affected thereby.

A corporation may acquire its own shares or shares of any other corporation, domestic or foreign, by gift or bequest or upon a merger or consolidation with or by distribution of the assets of another corporation, domestic or foreign.

A corporation shall not purchase or redeem shares of any class under this section in any case when there is reasonable ground for believing that the corporation is unable, or by such purchase or redemption, will be rendered unable, to satisfy its debts and liabilities when they fall due, except such debts and liabilities as have been otherwise adequately provided for. No redemption of shares shall be made if there be reasonable ground for believing that the net assets would be reduced thereby to an amount less than the lowest aggregate liquidation preferences of shares to remain outstanding having prior or equal claims to the assets.

The payment of a debt or liability shall be deemed to have been adequately provided for if the payment thereof shall have been assumed or guaranteed in good faith by a financially responsible person or persons.

(Construction of section.) Nothing in this section shall be construed to prohibit shares being forfeited to a corporation for delinquent assessments or nonpayment of the subscription price thereon.

A corporation shall be deemed to be controlled by another corporation when such other corporation is a

holding corporation thereof as defined in this title. (Added by Stats. 1931, p. 1800; Am. Stats. 1933, p. 1381.)

Sec. 342a. Effect of acquisition of own shares. When a corporation acquires its shares out of earned surplus, pursuant to subdivisions (1) to (8), inclusive, of section 342, Civil Code, or out of paid-in surplus under subdivisions (1) to (5), inclusive, of section 342, Civil Code, or by gift or bequest, or upon the distribution of the assets of another corporation, or upon forfeiture, such shares may be carried as treasury shares or may (at the option of the board of directors) be retired, but no change in the stated capital shall be made either upon the acquisition or retirement of such shares unless proceedings are duly taken to that end under section 348, Civil Code, except that when a corporation acquires its shares by purchase or forfeiture upon which part of the agreed subscription price remains unpaid, the stated capital shall be reduced by the amount unpaid upon such shares without further proceedings.

Out of stated capital. When a corporation acquires its shares out of stated capital, under subdivisions (1) to (5), inclusive, of section 342, Civil Code, such shares shall be restored to the status of authorized but unissued shares and the stated capital may be reduced by resolution of the board of directors by the amount of stated capital attributable to such shares. The amount of stated capital attributable to a share shall be determined by dividing the stated capital attributed to the class or series of shares to which such shares

belong by the number of shares of such class or series outstanding immediately prior to the acquisition of such shares.

Out of surplus. When a corporation acquires its shares out of surplus arising from reduction of stated capital, such surplus shall be reduced by the amount of the purchase price thereof and such shares shall be restored to the status of authorized but unissued shares without reduction of stated capital.

If the articles prohibit the reissue of any shares acquired, then upon their acquisition the authorized number of shares of the class to which such shares belonged shall be reduced by the number of shares so acquired.

Shares of the corporation surrendered to it on the conversion or exchange thereof into or for other shares of the corporation pursuant to authority or provision of the articles, shall, after such conversion or exchange, have the status of authorized but unissued shares, and the stated capital shall remain unchanged thereby and by the issue of the new shares in place of those so retired. (Added by Stats. 1931, p. 1800; Am. Stats. 1933, p. 1382.)

Sec. 342b. Treasury shares: (Status: Retirement: Disposition of consideration received: Reduction of stated capital). Treasury shares shall not carry voting or dividend rights and shall not be counted as outstanding shares for any purpose, nor as assets for the purpose of computing a surplus available for dividends or the purchase of shares issued by the corpo-

ration or the making of any other distributions to its shareholders. Unless otherwise provided in the articles, such shares may be retired and restored to the status of authorized and unissued shares without reduction of stated capital or may be disposed of for such consideration as the board of directors may fix, and the consideration received shall be added to paid-in surplus except as far as needed to write off a deficit of net assets below the amount of stated capital.

Redeemable shares. Redeemable shares which have been acquired from earned surplus and carried as treasury shares may be retired by resolution of the board of directors and stated capital may be reduced thereon as if acquired out of stated capital without proceedings under section 348, Civil Code. (Added by Stats. 1931, p. 1801; Am. Stats. 1933, p. 1383.)